IN THE

Supreme Court of the United States

October Term, 1976

No. 76-1794

IN THE MATTER OF THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY, Debtor

JACOB D. ZELDES, Successor Indenture Trustee Under The New York, New Haven and Hartford Railroad Company's General Income Mortgage Dated as of July 1, 1947,

Petitioner,

v.

MANUFACTURERS HANOVER TRUST COMPANY, Former Indenture Trustee Under The New York, New Haven and Hartford Railroad Company's First and Refunding Mortgage Dated as of July 1, 1947; and

RICHARD JOYCE SMITH, Trustee of the Property of The New York, New Haven and Hartford Railroad Company, Debtor,

Respondents.

BRIEF OF RESPONDENT MANUFACTURERS HANOVER TRUST COMPANY IN OPPOSITION

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BRIEF OF MANUFACTURERS HANOVER TRUST COMPANY IN OPPOSITION

Preliminary Statement

This brief is submitted on behalf of Manufacturers Hanover Trust Company ("Manufacturers") in opposition to the Petition for Certiorari filed by Jacob D. Zeldes, Successor Indenture Trustee under the General Income

Mortgage of The New York, New Haven and Hartford Railroad Company ("New Haven") to review a unanimous decision of the Court of Appeals for the Second Circuit which affirmed, so far as appealed, a decision of the District Court for the District of Connecticut, sitting as a Court for the Reorganization of a Railroad under Section 77 of the Bankruptcy Act, 11 U.S.C. § 205, determining fees and allowances, including attorneys' fees of certain trustees and former trustees.

Counterstatement of Questions Presented

The opinion of the Court of Appeals accurately sets forth the questions presented:

> (1) "Whether the New Haven reorganization court as a court of equity, had the authority, absent a specific statutory directive to the contrary, in the exercise of its discretion to allow or to deny compensation and expenses, including attorneys' fees, to an indenture trustee which concededly represented conflicting interests under very unusual circumstances; and
>
> (2) if so, whether the reorganization court exercised sound discretion in allowing the compensation and expenses in question" (App. 3a).*

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*For convenience, we refer to record references in the following fashion:

References to the appendix attached to the Petition for Certiorari are cited as "App. a."

References to the Petition for Certiorari are cited as "Pet. ."

References to the Joint Appendix on Appeal to the Second Circuit are cited as "Jt. App. A ."

Counterstatement of the Case

A clear and orderly statement of the facts pertinent here is found in the decision of the Court of Appeals (App. 3a-14a). However, because of certain errors in the Petition, and to acquaint the Court with the most important elements of the "unusual circumstances" emphasized by the Court of Appeals, the following points are noted here:

First, Petitioner persists in asserting that the Court of Appeals had no grounds for its unequivocal findings that Manufacturers made every possible effort to extricate itself from a sudden, unexpected and involuntary conflict situation and fully informed the Reorganization Court, which had supervised the New Haven reorganization from the beginning, of its predicament (Pet. 8-9; App. 8a, 28a-29a). The situation arose when, eight days before this Court's decision in the *New Haven Inclusion Cases*, 399 U.S. 392 (June 29, 1970), the Penn Central Transportation Company (Penn Central)* filed its petition for reorganization in the District Court in Philadelphia.

After careful consideration, the Court of Appeals unanimously approved the Reorganization Court's exercise of its plenary discretion which Petitioner here challenges anew. Petitioner again asserts (Pet. 10, fn. 3) that there is no evidence to support Manufacturers' statement that it had informed both the New Haven and Penn Central reorganization courts" (Court of Appeals Opinion, App. 8a) of the conflict situation when it suddenly arose. As was pointed out to the Court of Appeals, this erroneous assertion completely ignores the sworn statements of Horace J. McAfee (dated June 12, 1975), a senior partner of the firm representing Manufacturers, which was part of

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* The surviving entity after the merger of the Pennsylvania Railroad Company (Penn) and the New York Central Railroad Company (Central).

Manufacturers' application for an allowance, that (1) in July 1970, he advised counsel for the New Haven Reorganization Trustee and then the Trustee himself that Manufacturers had a potential conflict of interest because of its trusteeships of the New Haven and the Central, and would seek a qualified successor and resign, and asked the Trustee's counsel to so inform the Reorganization Court, and that (2) in September 1970, Mr. McAfee spoke with Judge Anderson about Manufacturers' decision to resign because of the conflicts and about its efforts to find a successor (Jt. App. A 220-221).* Mr. McAfee was tendered on two occasions for cross-examination at a hearing before the Reorganization Court on May 18, 1976, at which Petitioner was present (Jt. App. A 365-366, 382). Petitioner had no questions for Mr. McAfee and did not question his affidavit. Thus, the record completely supports the Court of Appeals' finding on this matter.

Second, Petitioner ignores the facts, fully supported in the record below and specifically found by the Court of Appeals, that immediately after Penn Central's bankruptcy, on June 21, 1970 Manufacturers, realizing the potential for conflict in its situation, took immediate action to find a qualified successor trustee for the New Haven's First Mortgage and resign (App. 8a).

The record is clear that Manufacturers promptly undertook an exhaustive search for a corporate trustee qualified to succeed it under the New Haven First Mortgage. The broad scope of that search was well known to the Reorganization Court (Jt. App. A 510) and was acknowledged by the Court of Appeals (App. 8a).

When it became apparent in the spring of 1971 that, despite these efforts, it was unlikely that any qualified

* Indeed, the Reorganization Court noted that it had itself tried to find qualified corporate successor trustees without success.

corporate successor trustee free from conflicts similar to those of Manufacturers and willing to undertake the trust could be found, the Reorganization Court, at Manufacturers' request, directed the appointment of a successor individual trustee in order that the trust of the New Haven First Mortgage might not fail for want of a trustee.

Upon the confirmation of Mr. Iannotti as successor trustee, any brief conflict which might have existed with respect to Manufacturers terminated since all fiduciary obligations* of Manufacturers to the New Haven *cestuis* ceased. Thereafter, Manufacturers had no further participation in the New Haven reorganization proceedings, except in matters relating directly to its fee application. Thus, Petitioner's assertions based on the existence of a continuing conflict are groundless.

Third, it is not the case, as Petitioner would have it, that "Manufacturers . . . had hired two counsel who had taken directly conflicting positions on the central issue facing [sic] reorganization. . . ." (Pet. 4). Manufacturers Trust Company, whose general counsel was Simpson Thacher & Bartlett ("Simpson Thacher"), and who served as trustee under the New Haven's First and Refunding Mortgage since 1947, merged in September 1961 with The Hanover Bank ("Hanover"). Hanover, whose counsel was Kelley Drye & Warren (as it is now known), had since the 1890's served as trustee under various Central mortgages. Thus, these representations were inherited, not confected.

When it was suddenly faced, by reason of the Reorganization Court's order and notice of August 10, 1970, with important questions relating to the reorganization of

* Other, of course, than a continuing obligation not to make any improper use of its former fiduciary position, an act of which there has been not the slightest suggestion during the course of these proceedings. See *Restatement (Second) of Trusts* § 170, comment g (1959).

the New Haven and of the Penn Central, rather than default in its then existing obligations to each group of *cestuis,* Manufacturers instructed both of its counsel to espouse positions which were in the best interests of each group of *cestuis.* To the extent that there was any alleged conflict in that brief period before the New Haven trusteeship could be responsibly resigned, it was a conflict in legal positions taken by counsel in papers publicly filed with the New Haven Reorganization Court, which ultimately decided in favor of the position of the New Haven representatives.

This was not a controversy between Manufacturers and Manufacturers, as Petitioner would have it. It was one between the New Haven interests (which sought an equitable lien and constructive trust and supported the jurisdiction of the New Haven Reorganization Court) and the Penn Central interests (which opposed the equitable lien and constructive trust and opposed the New Haven Court's jurisdiction). Each position was upheld by numerous well qualified and capable counsel. The fight was in the open; it was waged through filed briefs and at public hearings before the courts. The Court of Appeals was fully familiar with the controversy and all its implications for it ultimately reversed the Reorganization Court's decision, and sustained the Penn Central's position. *In re New York, New Haven & Hartford R.R.,* 457 F.2d 683 (2d Cir.), *cert. denied,* 409 U.S. 890 (1972).

Thus, in contrast to Petitioner's implication, the involvement of different counsel representing two different viewpoints in the New Haven reorganization proceedings in the second half of 1970 was the fortuitous result of historical allocations of work among counsel.* This sudden dilemma

* The Court of Appeals commented, "Indeed, the availability of separate counsel already representing each side was the single positive fortuity in this very difficult situation." (App. 30a, fn. 24)

was resolved in the only practical manner, and there was no departure from the most conscientious standards of fiduciary responsibility.

Reasons for Denying the Writ

Summary

As the Court of Appeals recognized, this is a unique case, and one singularly appropriate for resolution by a "wise and comprehending chancellor" (App. 3a). Because of the Penn Central bankruptcy, Manufacturers, which had for almost 10 years labored single-mindedly on behalf of the *cestuis* of the New Haven mortgage, suddenly found itself also obligated to act as a fiduciary for the contrary interests of the *cestuis* of Central mortgages. This unique dilemma was, as recognized by the Court of Appeals, wholly involuntary and due to no fault of Manufacturers.

While it was seeking to find qualified successors and then to resign, Manufacturers was obligated to represent these competing interests in a litigation which was then on-going. It made no secret of what it was doing or of the problem it faced; it so advised both reorganization courts and both sets of reorganization trustees. It authorized each of its counsel to take the necessary legal steps to defend the respective interests of the *cestuis* they represented, while it proceeded with its efforts to find those successors and resign.

Contrary to Petitioner's assertion, this case presents no broad question of federal bankruptcy policy. The Reorganization Court's decision, which the Court of Appeals unanimously affirmed, was a careful exercise of its traditional discretion as a court of equity on the specific facts before it. It reflects no error or abuse of authority, in

light of the special facts with which the courts below have dealt. The result is plainly equitable and correct.

As to the alleged conflict between the decisions below and those of this Court and of other Courts of Appeals, none has been shown. Rather, the cases reflect a consistent recognition of the well-settled principle that a reorganization court, as a court of equity, has discretion, absent an explicit statutory mandate to the contrary, to allow or to deny compensation and reimbursement to trustees and their counsel.

I. There Has Been No Showing of an Abuse of Discretion by the Reorganization Court in its Careful Exercise of the Traditional Powers of a Court of Equity.

As soon as it became apparent to senior management of Manufacturers in July 1970 that, upon the filing of Penn Central's petition for reorganization, Manufacturers faced a unique dilemma between its duties as the New Haven Indenture Trustee and its duties as Indenture Trustee for Penn Central mortgages, the bank immediately commenced steps, consistent with its obligations to all its *cestuis,* to take orderly and appropriate action to resign. However, realizing that it would be improper arbitrarily and summarily to cease carrying out its fiduciary functions for its New Haven and Penn Central *cestuis,* Manufacturers did three things: (1) it advised both Reorganization Courts that it had a conflict which it intended to cure by resigning as soon as it could find qualified successors; (2) it embarked upon an active search for such qualified successors; and (3) through its respective counsel it continued to represent the positions of the respective *cestuis.*

Nevertheless, according to Petitioner, any conflict—however brief, however technical, however involuntary—worked an immediate forfeiture of any and all compensa-

tion. Judge Timbers, writing for a unanimous Court of Appeals, totally rejected these contentions of Petitioner, pointing out that Manufacturers

> ". . . had no sooner conceived the idea to resign than its attorneys, on both sides, advised that it could not resign without leaving the bondholders stranded. Thus, on the advice of both of its firms of attorneys, Manufacturers chose the best *possible* alternative. . . ." (App. 29-30a, emphasis in the original).

We respectfully submit that Petitioner has misinterpreted the applicable provisions of trust law in his analysis of Manufacturers' obligations to its New Haven *cestuis.* Judge Anderson has exercised uninterrupted judicial supervision of the New Haven reorganization for a period of more than sixteen years. It is beyond dispute that he is intimately familiar with these proceedings and in the best position to have judged the propriety of the actions by Manufacturers.

After a consideration of voluminous supporting material and based upon its knowledge of the facts, the Reorganization Court made the awards challenged here. As the Court of Appeals pointed out, to reach the contrary conclusion urged by Petitioner would ". . . strip the reorganization court as a court of equity of its authority to exercise sound discretion" and ". . . would render equity inequitable." (App. 15a). We do not believe that Manufacturers, having involuntarily and through no fault of its own (as has been concluded by both courts below) found itself in an impossible situation, was obligated to throw up its hands and do nothing to protect its *cestuis* to avoid endangering its just compensation for ten years of diligent service prior to that time. To the contrary, we submit that

had Manufacturers abandoned its fiduciary obligations it might have exposed itself to proper censure by the Reorganization Court. The nature and value of the services rendered during those ten years are fully set forth in the record, cf. Jt. App. A 516-A 520; no one questions them. Judge Anderson applied what he regarded as a proper penalty for the conflict he found by making Manufacturers' compensation contingent. No equitable considerations suggest that a reorganization court should not have such discretion or that it was abused here.

II. The Decision Below Does Not Conflict With Either This Court's Decision in the *Woods* Case or with Decisions of Other Courts of Appeals.

Petitioner argues that the decisions below are in conflict with *Woods* v. *City National Bank & Trust Co.*, 312 U.S. 262 (1941) because, in his view, *Woods* requires automatic disallowance of fees and expenses whenever a reorganization court finds conduct which it characterizes as involving a "conflict of interest" or "breach of trust". As the Court of Appeals recognized (App. 16a-19a), this was not the holding of *Woods*. *Woods* reinstated a decision of a reorganization court exercising its discretion to deny allowances to self-dealing trustees and their self-dealing counsel.

As the Court below noted, the fact pattern in *Woods* was:

> ". . . in sharp contrast to that in the instant case. There, claims for compensation were filed by an indenture trustee, the members of a bondholders' committee, and the committee's counsel. The bondholders' committee, originally organized by the indenture trustee, included employees of the indenture trustee's corporate reorganization department as well as employees of an underwriter heavily interested in the debtor's stock and under threat of suit for defrauding the bondholders. The same firm of attorneys which had been retained by the indenture trustee was employed by the committee. Thus the interlocking personnel of the committee and the indenture trustee represented the depositing bondholders who were interested in having a low upset price fixed for the debtor's property, the nondepositing bondholders who were interested in a high upset price, and a large stockholder who sought a favorable position in the reorganization at the expense of both. The essential ground upon which the reorganization court disallowed the claims for compensation was that the claimants were pursuing interests of their own that were either of no benefit to the estate or were adverse to it." (App. 17a, fn. 14)

This Court noted in *SEC* v. *Chenery Corp.*, 318 U.S. 80, 89 (1943) that:

> "Woods v. City Bank Co., 312 U.S. 262, held only that a bankruptcy court, in the exercise of its plenary power to review fees and expenses in connection with a reorganization proceeding under Chapter X of the Chandler Act, 52 Stat. 840, could deny compensation to protective committees representing conflicting interests."

Cf., with respect to the broad equitable power of a bankruptcy court, *American United Mutual Life Ins. Co.* v. *City of Avon Park,* 311 U.S. 138, 146 (1940); *SEC* v. *United States Realty & Improvement Co.*, 310 U.S. 434, 455 (1940).

The Second Circuit in *Berner* v. *Equitable Office Bldg. Corp.*, 175 F.2d 218 (2d Cir. 1949) and *Silbiger* v. *Prudence*

Bonds Corp., 180 F.2d 917 (2d Cir. 1950), consistent with the teachings of *Woods*, has recognized the power of a district court, in its discretion, to grant or deny fees to a fiduciary in a reorganization proceeding who had acted disloyally (in *Berner*, an attorney who had disclosed inside information; in *Silbiger*, an attorney who had represented two classes of bondholders, whose interests conflicted). In the latter case, this Court denied a petition for certiorari filed by the Trustee and supported by the SEC, *sub nom. Prudence Bonds Corp.* v. *Silbiger*, 340 U.S. 831 (1950), alleging, *inter alia*, that that decision was in conflict with *Woods.** See also *Chicago & West Towns Rys.* v. *Friedman*, 230 F.2d 364 (7th Cir.), *cert. denied sub nom. Elward* v. *Friedman*, 351 U.S. 943 (1956), where the court found a conflict of interest which petitioning attorneys had taken some trouble to conceal. The court affirmed a reduced award, saying (230 F.2d at 369):

> "Authority exists for the disallowance of all fees [citing *Woods*]. But in several reorganization cases a less harsh rule has been adopted. A penalty of less than full forfeiture was approved in [*Silbiger* and *Berner*]. We may decide the extent of the penalty."

Clearly, Judge Anderson understood that upon deciding there had been a conflict of interest, he was empowered in the exercise of his discretion to *deny* compensation. Neither *Berner* nor *Silbiger* questions that power. What they do recognize, as did Judge Anderson, is that a chancellor having a view to all of the circumstances, may, in his discretion, *award* compensation and apply limits which his

* Petitioner cites only 340 U.S. 813, where this Court denied the attorney's petition.

discretion may suggest. So, we submit, do the other Courts of Appeals.*

In re Midland United Co., 159 F.2d 340 (3d Cir. 1947), cited by petitioner (Pet. 23) as indicating a contrary view on the part of the Third Circuit, in fact deals with transactions specifically prohibited under Section 249 of the Bankruptcy Act. Discussing *Woods* and *American United Mutual Life Insurance Co.* v. *City of Avon Park, supra*, the court stated:

> "They hold, as already pointed out, that the bankruptcy court had plenary power to deny compensation to a fiduciary in a reorganization proceeding 'where an actual conflict of interest exists' regardless of whether 'fraud or unfairness' resulted." 159 F.2d at 346.

Finding that there was such a conflict, the Circuit Court affirmed the decision of the District Court to deny compensation.

In *Carey* v. *Selected Investments Corporation*, 319 F.2d 578 (10th Cir. 1963) cited by Petitioner (Pet. 22) as being in conflict with the Second Circuit's decision here, the Tenth Circuit noted,

> "Section 241 of the Bankruptcy Act . . . provides in presently pertinent part that the judge may allow reasonable compensation to the attorney for the debtor. Under such grant, the court has implied plenary power to review a claim for services of that kind and to disallow it if the attorney at the time of the rendition of the services also represented

* Instructively, Petitioner has never previously referred to any of the decisions of Courts of Appeals he now claims are in conflict with the decisions below.

another party or parties having interests in conflict with those of the debtor",

citing *Woods,* 319 F.2d at 580, and thereupon affirmed the determination of the District Court denying compensation. Thus, both the Third and the Tenth Circuits, contrary to Petitioner's claim, are consistent with the Second and Seventh Circuits in recognizing the discretion of the Reorganization Court to grant, modify or deny compensation when faced with a conflict of interest or a breach of trust.

Young v. *Potts,* 161 F.2d 597 (6th Cir. 1947), was an action for an accounting against a stockholder-lawyer who had taken an appeal on behalf of a class of stockholders and then sold his shares and the appeal for a substantial premium. In a subsequent accounting action, he sought to credit against the judgment for the premium his expenses and those of his law partner incurred in taking the appeal he had sold. While it is not clear from the opinion whether the decision of the Sixth Circuit disallowing any credit for fees and expenses was based upon the fact situation there presented, upon the absolute proscription in Section 249 of the Bankruptcy Act, 11 U. S. C. § 649, discussed *infra,** or upon the court's construction of the *Woods* and *Avon Park* cases, *Young* v. *Potts,* an obvious self-dealing case, is plainly not applicable to the facts here.

* Petitioner's quotations from *Young* v. *Potts* (Pet. 22) clearly relate to the court's discussion of Section 249 of the Bankruptcy Act. The full quotation is:

> "No credit will be allowed to Potts as compensation for his own time, or for fees to counsel or out-of-pocket expenses. The courts have repeatedly pointed out in interpreting Section [249 of the Bankruptcy Act], that trafficking in the securities of the debtor has been one of the most persistent evils in reorganization [citations omitted]. Potts gambled at his own risk. The gamble failed and he must foot the bill." 161 F.2d at 600.

III. Petitioners' Reliance Upon *Wolf* v. *Weinstein* and Other Cases Construing § 249 of the Bankruptcy Act, is Misplaced.

As we have noted, and as the Courts of Appeals have consistently recognized, there are situations where Congress has, by statute, limited the discretion of reorganization courts to grant fees and allowances. Section 249 of the Bankruptcy Act, 11 U.S.C. § 649, which precludes any allowance for fees or expenses to a reorganization fiduciary who has engaged in insider trading, is such a statute. *Wolf* v. *Weinstein,* 372 U.S. 633 (1963), deals with the definition of the scope of that statute, specifically, whether responsible managing employees are fiduciaries within the meaning of § 249.* This Court held that they were, and therefore were subject to § 249's absolute prohibition. In light of its decision as to the reach of the statute, the Court found no room to apply traditional equitable principles in mitigation, such as the *de minimis* rule and the power of the chancellor to limit the forfeiture to future payments. *Wolf* v. *Weinstein, supra,* 372 U.S. at 654-55.**

Petitioner's reliance upon *Wolf* and other § 249 cases, e.g., *In re Midland United Co., supra; Young* v. *Potts, supra,* is misplaced. No one contends that § 249 applies here. The Second Circuit properly rejected Petitioner's efforts to synthesize from this Court's decisions in *Woods* and *Wolf* a single doctrine barring all fees and allowances. It stated "we believe that *Wolf* bears only marginally, if

* Section 249 is a companion statute to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 p(b). See *Wolf* v. *Weinstein, supra,* 372 U.S. at 643, fn. 11.

** Petitioner refers to this passage (Pet. 18, 24), but fails to recognize that this Court's discussion relates to the *statutory* penalty. The sentence he quotes is followed by this statement: "Thus the policies of the statute afford no alternative but to order the restitution of all amounts. . . ." 372 U.S. at 654.

at all, on the question presented by the instant appeal" (App. 21a-22a).*

While *In re Inland Gas Corp.*, 309 F.2d 176 (6th Cir. 1962), cited by Petitioner (Pet. 26-27), invokes, as Petitioner avers, a rule of "strict enforcement", it is a rule of "strict enforcement of the Section 249, although often resulting in an obvious financial hardship, [which] is necessary in order to discourage and eliminate"

> "trafficking in the securities of the debtor [,] . . . one of the most persistent evils in reorganization which Congress attempted to eliminate in its enactment of Section 249 of the [Bankruptcy] Act, [citing *Young* v. *Potts, supra,* and *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea,* 266 F.2d 862 (2d Cir.), *cert. denied,* 361 U. S. 862 (1959)]." 309 F.2d at 181.

Thus, contrary to Petitioner's assertion, there is no broad *Wolf-Woods* synthesis which precludes compensation and reimbursement on the facts of this case, but rather a general recognition of the equitable discretion of the reorganization court, subject to specific statutory exceptions.

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* Petitioner's reliance (Pet. 25, 26) on *Mosser* v. *Darrow,* 341 U.S. 267 (1951), is also misplaced. He ignores the fact that *Mosser* was not an allowance case but a self-dealing case. The Court held in *Mosser* that a bankruptcy trustee—who had authorized and failed to disclose a conflict of interest between his employees and the bankrupts—could be surcharged for the employees' profits. The trustee employed two assistants in managing bankrupt holding companies on terms which permitted those employees to trade for their own profit in the securities of the companies at the same time as the trustee was purchasing them. The trustee made no disclosure of this agreement. "Indeed, it appears that he did not even disclose this feature of the transaction to his own counsel." 341 U.S. at 274. The *Mosser* case clearly does not require the unfair result which Petitioner asks this Court to impose.

Conclusion

The decision of the court below, affirming the decision of the Reorganization Court so far as appealed from, is correct and does not present an issue warranting review by this Court. There has been no showing of any conflict between the decision below and that of other circuits or of this Court. No question of general federal reorganization or bankruptcy policy is involved. The petition should be denied.

Respectfully submitted,

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